SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 424

MEMPHIS NATURAL GAS COMPANY,
Appellant,

vs.

GEORGE F. McCANLESS, COMMISSIONER OF FINANCE AND TAXATION OF THE STATE OF TENNESSEE, AND J. C. JOHNSON, CONSTABLE OF SHELBY COUNTY, TENNESSEE,
Appellees.

APPEAL FROM THE SUPREME COURT OF TENNESSEE

REPLY OF APPELLANT TO THE MOTION TO DISMISS

The motion to dismiss insists that appeal is not the proper remedy and cites *Memphis Natural Gas Co.* v. *Beeler*, 315 U. S. 357, in which the appeal was dismissed and certiorari granted.

> "It is not enough that an appellant could have launched his attack upon the validity of the statute itself as applied; if he has failed to do so, we are without jurisdiction over the appeal."

The test of the question is stated therein:

> "Since it does not appear that the validity of the statute was either drawn in question or passed upon in the trial court or deemed by the State Supreme Court to be an issue, we must dismiss the appeal for want of jurisdiction."

But in the appeal at bar the Supreme Court of Tennessee recognized that appellant launched its attack upon the validity of the statutes as applied.

> See Page 10 of the Statement as to Jurisdiction, the Assignments of Error in the Supreme Court of Tennessee and a part of the opinion specifically recognizing the appellant's attack upon the application of the statutes to appellant.

Plainly the constitutional questions were in issue in the Supreme Court of Tennessee. The motion to dismiss next delves deeply into the merits of the controversy. We do not understand this is the point in this appeal to go extensively into the merits of the controversy, and therefore make this reply rather brief and by no means exhaustive of the important questions involved.

The Supreme Court of Tennessee applied the statutes to appellant because it decided the pipe line corporation is a public utility distributing gas.

It is most difficult to understand how anyone can reach such a conclusion. It is undisputed and admitted that the Memphis Natural Gas Company does not own or operate any service pipes or distributing plant or facilities. *How then is it humanly possible for the appellant to be a public utility distributing gas in Tennessee when it has absolutely no facilities or means to distribute anything or render any service to the public?*

It is just as absurd to say that one is engaged in the railroad business though it has no railroad or railroad equipment.

There is no substantial basis for the state court decision. It is a colorable decision for the determined purpose of subjecting an important interstate property to local control and mulcting it annually to support the State Commission. The constitutional issues were ignored and resort had by the Supreme Court of Tennessee to tenuous arguments and erroneous factual assumptions to transform private property into a public utility in violation of simple and basic constitutional rights.

In such a situation the words of this court in *Memphis Natural Gas Co.* v. *Beeler* are apt:

> "We examine the contract only to make certain that the non-federal ground of decision is not so colorable or unsubstantial as to be in effect an evasion of the constitutional issue."

We respectfully submit that this state decision violates the principle just quoted. If it is not corrected and clarified, there will rain upon this court in succeeding years a multitude of cases from state courts stemming from this decision which says that if a private corporation is entitled by contract to some of the profit made by a public utility, the recipient private corporation is thereby transformed and converted into a public utility of the same kind—though it has no physical means to distribute anything or to serve the public in any manner.

Such an artificial conclusion is no different from saying that if a landlord rents his property to a light, gas or water public utility on the basis of the rent being measured by a percentage of the profits, the landlord thereby becomes a public utility. The profit-sharing arrangement between Memphis Natural Gas Company, the pipe line corporation, and the Memphis Power & Light Company, the distributing utility, is no different in principle from the illustration stated. Pursuant to the contract the pipe line corporation

sold the gas to the distributing utility, and the price was measured in part by the profit made by the distributing utility. Such plainly is the effect of the contract, and as stated by this court in *Memphis Natural Gas Co.* v. *Beeler.*

The late Mr. Justice Cardozo, discussing a somewhat similar situation in *People ex rel. Pennsylvania Gas Co.* v. *Saxe, et al.*, 229 N. Y. 446, 128 N. E. 673, on page 674 stated in connection with a profit-sharing price formula:

> "We think the interstate character of the relator's business is untouched by these arrangements"
>
> and
>
> "the sale does not cease to be one in interstate commerce because the price is to be measured by the purchaser's receipts."

This language can properly be paragraphed: The sale by the pipe line, the private corporation, to the distributing company does not change the character of the private corporation and cause it to be transformed into a public utility "because the price is to be measured by the purchaser's receipts."

Is it not indeed a challenge and a serious thing to confiscate private property for public purposes upon the expedient that the price to be paid by a distributing company to a pipe line corporation for gas is measured in part by the distributing company's profits? Is it not disturbing and shocking that the Supreme Court of Tennessee has used this method of determining the price for gas as an excuse to require the pipe line corporation to pay $5,000.00 a year "to reimburse the State" for regulation and inspections which never took place and are the rankest of rank fiction? The motion to dismiss states that there were during the years involved inspections of the appellant's pipe line. This is altogether erroneous and there is no dispute

about the fact. The State took no proof. The appellant's proof is undisputed.

Mr. Johnson, the President of the pipe line corporation, testified on direct examination:

> "Q. 27. Has a representative of the Railroad and Public Utilities Commission or of the State of Tennessee prior to the filing of this suit inspected the properties of the Memphis Natural Gas Company in the State of Tennessee?
>
> A. Not to my knowledge."

On cross-examination he testified:

> "Q. 89. Did you know of Mr. Williams', chief engineer of this Commission, visit to your company last year, and did you know that he contacted some representative of your company?
>
> A. I don't believe I met Mr. Williams at the time, but I understood he was at the office in Memphis.
>
> Q. 90. And did you know that some representative of your company took him over your properties?
>
> A. Yes, but that was at a date after the filing of this suit."

The Chief Engineer of the State Commission visited for the first time the properties of the pipe line *after this suit was filed* because the complaint charged there had never been any attempted control, regulation, inspection or supervision of appellant's properties by the State or any of its agencies. Therefore the State had done nothing for which reimbursement could be claimed under the police power.

Mr. Dearth, Secretary-Treasurer of the pipeline corporation, testified on cross-examination:

> "Q. 95. Did you go out with Mr. Williams, the Chief Engineer of the Commission, at the time that he was down in Memphis going over the property of your company, or did you go out with any other engineer or representative of the Commission?

A. Another representative went with Mr. Williams over the properties. I talked with Mr. Williams in the office, but I did not make any trips with him over the lines or system."

The foregoing is all of the proof about inspections. It is beyond dispute that the visit by Mr. Williams, Chief Engineer, was after this suit was instituted.

The motion to dismiss states that this evidence means that Mr. Williams made his inspection prior to the institution of this suit and during the years involved in the controversy. On this point the Supreme Court of Tennessee stated:

"* * * we think the undisputed evidence of the Gas Company's witness Dearth makes it clear that the Commission did make some inspections of the operation and properties of the Gas Company" etc.

Yes, after the controversy developed and the suit was instituted and for the purpose of bolstering the State's position.

This point has been discussed by us to illustrate and show that the state decision is built upon erroneous assumptions of fact to justify the application of the State statutes to appellant. Their effect is to strip appellant of its constitutional rights.

The motion to dismiss states that the franchise from the City of Memphis to distribute gas was granted to the pipe line corporation, and the Supreme Court of Tennessee made a similar statement:

"* * * the Gas Company was operating under privileges and franchises from the City of Memphis" etc.

This is equally erroneous. This court stated in *Memphis Natural Gas Co.* v. *Beeler*:

"The contract (between pipe line corporation and distributing company) was entered into as a prelim-

> inary to the award by the City of Memphis to the Memphis Company (Memphis Power & Light) of its franchise to distribute gas to consumers, and the execution of the contract was a condition of the grant of the franchise." (Parenthetical insertions ours.)

In other words the distributing Company, Memphis Power & Light Company, could not get a franchise from the City of Memphis until it showed that it had a contract with a pipe line corporation to supply it with gas. After making such a contract with the pipe line corporation, the distributing company then filed it with the City of Memphis as a part of its application for a franchise to distribute gas in Memphis. These undisputed facts are said to mean that the City of Memphis granted to the Memphis Natural Gas Company, the pipe line corporation, the franchise to distribute gas in Memphis.

These adverse but material and unsupported findings of fact are the pegs on which the state decision hangs, and are the excuse to apply to appellant the State statutes in denial of its constitutional rights.

Are such results right and do they conform to constitutional guaranties? In our humble judgment, the answer should be no.

The fundamental, controlling and undisputed fact is that appellant has no distributing facilities and does not serve the public.

Memphis Natural Gas Co. v. *Beeler,* 315 U. S., p. 652 so states:

> "Taxpayer, a Delaware corporation, was engaged during the period in question in the business of purchasing natural gas in Louisiana and transporting it through its pipe line to points in Tennessee where it delivered the gas into the pipe lines of two distributing companies—Memphis Power & Light Company and West Tennessee Power & Light Company—which sold the gas to local consumers."

Memphis Natural Gas Co. v. *Pope*, 178 Tenn. 584.

> "The distributing lines and appliances for sale and distribution belong to Memphis Power & Light Company."

Memphis Natural Gas Co. v. *McCanless*, 180 Tenn., Page 691 states:

> "The distributing agencies pay the complainant for the gas taken by them at these various connections and the complainant has nothing to do with the distribution and sale of the gas by such agencies.
>
> "Upon these facts we do not think it can be said that the complainant is distributing natural gas or is a distributor of natural gas in Tennessee."

It should be borne in mind that each of the above three cases deals with facts existing in each of the years involved in this present appeal, and by stipulation these facts are a part of the appellant's proof.

In all three of the above decisions it was found that the appellant has no distributing facilities and does not serve the public. In the present appeal the Supreme Court of Tennessee goes counter to the facts decided not only by it, but also by this court. In the motion to dismiss it is stated that the last above quotation was made concerning years subsequent to those here involved. Again the appellees are in factual error. The suit involved the pipe line corporation's liability for a gross receipts tax for the privilege of distributing natural gas and imposed by Chapter 108 of the Public Acts of 1937. The Supreme Court of Tennessee stated on Page 693:

> "We do not think there is any liability on the part of the complainant for the gross receipts tax during the time in which gas was being distributed as a joint enterprise by complainant and Memphis Power & Light Company."

This necessarily deals with the period from 1937, the date of the passage of the Act, thoughout the time the profit-sharing contract between the pipe line corporation and the distributing company was in existence.

It was decided by this court in *Memphis Natural Gas Co.* v. *Beeler* that the pipe line corporation had to pay the Tennessee corporation excise tax because it had income from local Tennessee business—its part of the profit made by the distributing company. This court said on Page 653:

> "It follows that if the Supreme Court of Tennessee correctly construed taxpayer's contract with the Memphis (Power & Light) Company as establishing a profit-sharing joint adventure in the distribution of gas to Tennessee consumers, the taxpayer's *net earnings under the contract* were subject to local taxation."

The profit-sharing arrangement and the receipt by the pipe line corporation of its share of profits made by the distributing company caused this court to conclude that the pipe line corporation has to pay the corporation excise tax on the income so received from Tennessee intrastate business. This was the decisive point.

The State Supreme Court translates this in the present appeal to mean that the pipe line corporation is a public utility and that the Tennessee statutes are applicable to it. Obviously this is unsound and fantastic.

There are other important questions involved which we will not undertake to here discuss as we understand it is improper procedure to do so on this jurisdictional motion. Some of the other important Federal questions involved are the conflict of the Tennessee decision with the Federal Natural Gas Act of 1938, the plain invasion by the State of the Federal right to control and regulate interstate commerce, the confiscation of private property for public uses in violation of the Fourteenth Amendment

and other highly important and substantial Federal questions.

The basis of the Tennessee decision is unsubstantial and artificial. If a state court ignores material and undisputed facts and decides them in a manner inconsistent with the undisputed facts and thus strips the appellant of its constitutional rights, there is no other recourse than this very important right of appeal which appellant respectfully prays.

Respectfully submitted,

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